

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM**  
**STATEMENT OF INVESTMENT POLICY**  
  
**FOR**  
**PASSIVE INTERNATIONAL EQUITIES – EXTERNALLY MANAGED**

**February 14, 2005**

*This Policy is effective immediately upon adoption and supersedes all previous for externally managed passive international equities policies.*

**I. PURPOSE**

This document sets forth the investment policy ("the Policy") for the Externally Managed Passive International Equities Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and capturing returns associated with this segment of the global capital markets.

**II. STRATEGIC OBJECTIVE**

Obtaining broad diversification across international equity markets at a low cost in developed and emerging international markets is the strategic objective of the Program.

The Program shall be managed to accomplish the following:

- A.** Diversify the System's equity program;
- B.** Enhance the System's expected total return;
- C.** Hedge against active member (pre-retirement) liabilities; and
- D.** Consider solely the interests of the System's participants and their beneficiaries in accordance with California State Law.

**III. RESPONSIBILITIES AND DELEGATIONS**

- A.** The **System's Investment Committee** ("Investment Committee") is responsible for approving and amending the Policy. The

Investment Committee delegates the responsibility for administering the passive international equities portion of the System to the Investment Staff through the Delegation of Authority (Delegation Nos. 89-13 and 95-50).

**B.** The **System's Investment Staff's** ("the Staff") duties include, but are not limited to, the following:

1. Developing and recommending the Policy to the Investment Committee.
2. Developing and maintaining a procedures manual subject to periodic reviews and updates outlining Staff operational procedures used in implementing this Policy.
3. Implementing and adhering to the Policy.
4. Recommending action in accordance with the Manager Monitoring - Externally Managed Policy concerning the following:
  - a. outside money management firm(s) ("Managers") retained under contract to implement the Program, and
  - b. changes in the Manager's contractual guidelines, and any other aspect Staff considers pertinent.
5. Reporting to the Investment Committee, as needed, about the performance of the Program. The Staff shall monitor implementation of, and compliance with, the Policy. The Staff shall report concerns, problems, material changes, and all violations of Guidelines and Policies immediately and in writing to the Investment Committee. Reports made by the Staff to the Investment Committee shall include explanations and appropriate recommendations for corrective action.

**C.** **Each Manager** is responsible for all aspects of portfolio management as set forth in each Manager's contract with the System and shall fulfill the following duties:

1. Communicate with the Staff, as needed, regarding investment strategy and investment results. The Manager is expected to monitor, analyze, and evaluate performance relative to the agreed-upon benchmark.

2. Cooperate fully with the System's Staff, Custodian, and General Pension Consultant concerning requests for information.

**D.** The **General Pension Consultant** is responsible for monitoring and evaluating the Managers' performance relative to the benchmark and Policy. The General Pension Consultant shall report to the Investment Committee on a quarterly basis, in accordance with its contract.

#### **IV. PERFORMANCE OBJECTIVE**

The Portfolio shall track the performance of the benchmark with a realized return deviation (tracking error) of no more than 25 basis points annually. During short time periods, tracking error may fall between 25 and 60 basis points.

#### **V. INVESTMENT APPROACHES AND PARAMETERS**

##### **A. Approaches**

1. Given the large asset base that the System invests, the System shall manage a significant portion of its international equity exposure in a passive investment program.

The allocation to passive management reflects a trade-off between the potential for value added through active management and the practical limitations inherent in managing a very large pool of non-U.S. assets. Management of the passive portfolio shall achieve the following:

- a. **Diversification** - A passive approach assures that the System shall achieve its goal of broad exposure to the securities included in the benchmark.
- b. **Certainty of Returns** - Returns from passive management shall track the benchmark with a low level of volatility. Therefore, the System shall lower the risk of significantly underperforming the benchmark.
- c. **Efficiency** - With a passive strategy, deploying larger amounts of money is possible.

- d. Low Cost - Management fees and transaction costs for passive management are lower than for active management.

The Manager is charged with constructing and maintaining a portfolio consistent with the stated performance objective in Part IV. of this document, and closely resembles the risk characteristics of the benchmark index.

To further reduce costs, the indexed portfolio may be constructed as a commingled fund as opposed to a separate account.

International equity index futures and index swaps may also be utilized to increase or decrease international equity exposure.

2. The program shall be implemented through the retention of an external manager(s). External manager selection shall occur in accordance with Section III.B. of this Policy.
3. The viability of the Program shall be reviewed continually, with a formal review at least every five years.

#### **B. External Manager Selection**

1. The System shall retain Manager(s) which have recognized expertise in the analysis and selection of international equity securities or approved derivatives. The Manager(s) shall be registered, or appropriately exempt from registration, with the Securities and Exchange Commission.
2. The System shall select the Manager(s) in accordance with its Contract and Procurement Policy.

#### **C. Investment Parameters**

The Manager(s) shall operate under a set of specific guidelines that outlines their investment philosophies and approaches, representative portfolio characteristics, permissible and restricted securities and procedures, and performance objectives representative of their strategic role within the System's Investment Program and the investment risks incurred.

Implementation of this Program shall comply at all times with the System's investment policies including, but not limited to, the

following:

1. Permissible Equity for Emerging Equity Markets policy;
2. Foreign Exchange Guidelines;
3. Statement of Investment Policy for Derivatives - External Money Managers;
4. Proxy Voting Policies;
5. Manager Monitoring - Externally Managed; and
6. Manager-specific Investment Management Guidelines.

## **VI. BENCHMARK**

- A.** The benchmark is an index that includes both developed and emerging markets components, and measures returns on an unhedged basis. The markets and securities in the benchmark are capitalization-weighted.
- B.** The benchmark is the CalPERS Financial Times Stock Exchange (FTSE) All World, ex US, ex Tobacco, Capitalization Weighted Index. The markets included are limited to the countries in the System's Permissible Equity for Emerging Equity Markets Policy, and may be subject to additional restrictions at the discretion of the Investment Committee. This index excludes tobacco securities.
- C.** An independent source (FTSE) is responsible for maintaining the benchmark as well as calculating and reporting the return of the benchmark to the System and the Manager.

## **VII. GENERAL**

- A.** Terms in this policy are defined in a master glossary of terms.
- B.** The System shall make all calculations and computations on a market value basis, as recorded by the System's Custodian.

## **VIII. GLOSSARY OF TERMS**

The Equities Glossary of Terms is referenced in the System's Master Glossary of Terms.